



UNIVERSITI PUTRA MALAYSIA

**SHAREHOLDER GAINS DURING THE
BANK MERGER ANNOUNCEMENTS IN MALAYSIA**

LEE MIANG HUA

FEP 2002 12

**SHAREHOLDER GAINS DURING THE BANK MERGER ANNOUNCEMENTS
IN MALAYSIA**

By

LEE MIANG HUA

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia,
in Fulfilment of Requirement for the Degree of Master of Science**

July 2002



DEDICATION

This thesis is dedicated to all my friends especially to my beloved parents.

Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment of the requirement for the degree of Master of Science

**SHAREHOLDER GAINS DURING THE BANK MERGER
ANNOUNCEMENTS IN MALAYSIA**

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July 2002

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This paper analyzes the shareholder gains surrounding the Malaysian bank merger announcements on 29th July 1999 and 14th February 2000. Initiated by the Bank Negara Malaysia (BNM) in the midst of financial crisis, the merger was not a market driven one in its real sense. In particular, this study measures the impact of these merger announcements on the appointed anchor bank, its target bank and combined bank. We find that all CAR_t are statistically insignificant at any conventional level regardless of the category during event window of 61-day and 11-day. We believe this is because these mergers are arranged by BNM and are not market driven. There are shareholder gains during the 11-day window for the combined bank category but the finding is not statistically significant. However, they show slight positive returns but not substantial during the 61-day window. We also find that the shorter periods ie. 11-day (-5,+5) would give higher level of CAR_t than longer periods ie. 61-day (-30,+30) in both initial and revised announcements. There are differences in CAR_t between the initial and revised announcements even though both announcements are arranged by BNM and involved the

same banks. We believe that the differences are mainly due to greater flexibility being given to banks on merger during the revised announcement. There are also differences in cumulative abnormal returns among the categories namely anchor bank, target bank and combined bank during the 61-day window but for the event window 11-day, our finding conclude that there is at least one category of CAR_t which is similar with the other categories. For both event windows of 61-day and 11-day, CAR_t have a positive and statistically significant relationship with the relative shareholders' funds of the anchor bank (SHR) and New Anchor bank (NEW), and inverse relationship with the relative size of anchor to target banks (ASSET).

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia
sebagai memenuhi keperluan untuk ijazah Master Sains

**KEUNTUNGAN PEMEGANG SAHAM SEMASA PENGUMUMAN
PENGGABUANGAN BANK-BANK DI MALAYSIA**

Oleh

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Tujuan tesis in adalah untuk menganalisis keuntungan pihak pemegang saham semasa pengumuman penggabungan bank-bank pada 29hb Julai 1999 and 14hb Februari 2000 di Malaysia. Disebabkan penggabungan ini adalah dianjurkan oleh Bank Negara Malaysia (BNM) semasa krisis kewangan, ia tidak boleh dianggap sebagai penggabungan yang didorong oleh faktor-faktor pasaran bebas dalam erti kata yang sebenar. Secara khusus, tujuan tesis ini adalah untuk mengukur kesan pengumuman penggabungan terhadap bank induk yang dilantik, bank sasaran and bank tergabuag. Kajian ini mendapati bahawa semua CAR_t tidak mencapai taraf keertian yang tinggi dalam tempoh jendela peristiwa 61 hari dan 11 hari. Ini adalah kerana penggabungan bank-bank ini adalah diatur oleh BNM dan bukan didorong oleh pasaran bebas. Kami mendapati ada keuntungan bagi pihak pemegang saham dalam tempoh 11-hari tetapi keuntungan bagi tempoh 61-hari tidak tinggi. Kami juga mendapati bahawa CAR_t adalah lebih tinggi bagi tempoh yang lebih pendek seperti tempoh 11hari. Tesis in juga mendapati bahawa ada perbezaan antaran pengumuman awal and pengumuman kedua disebabkan pertukaran syarat dalam pengumuman kedua. Terdapat juga perbezaan dalam pulangan tidak normal terkumpul di

kalangan kategori-kategori berkenaan iaitu bank peneraju, bank sasaran dan bank tergabung dalam jendela 61-hari tetapi bagi jendela peristiwa 11-hari, kajian ini merumuskan bahawa terdapat sekurang-kurangnya satu kategori CAR_t yang serupa dengan kategori yang lain, Bagi kedua-dua jendela peristiwa 61-hari and 11-hari, CAR_t mempunyai perkaitan positif dan signifikan dari segi statistik dengan dana pemegang saham bank peneraju (SHR) dan bank peneraju baru (NEW) dan perkaitan songsang dengan saiz bank peneraju berbanding saiz bank sasaran (ASSET)

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I certify that an Examination Committee met on 11th July 2002 to conduct the final examination of Lee Miang Hua on his Master of Science thesis entitled "Shareholder Gains during the Bank Merger Announcements in Malaysia" in accordance with Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulations 1981. The Committee recommends that the candidate be awarded the relevant degree. Members of the Examination Committee are as follows:

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I hereby declare that the thesis is based on my original work except for quotations and citations, which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.



LEE MIANG HUA

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LIST OF ABBREVIATIONS

AAR – Average Abnormal Return
AFTA – Asean Free Trade Area
BAFIA – Banking and Financial Institutions Act 1989
BCB – Bumiputra Commerce Bank
BIS – Bank for International Settlements
BNM - Bank Negara Malaysia
CAR – Cumulative Abnormal Return
CDRC - Corporate Debt Restructuring Committee
DBS – Development Bank of Singapore
MRCB – Malaysia Resources Corporation Berhad
NPL –Non Performing Loan
ROA – Return on Asset
ROE – Return on Equity
RWCR – Risk Weighted Capital Ratio
SC – Securities Commission
TTRS - Two –Tier Regulatory System
VSS – Voluntary Separation Schemes
WTO - World Trade Organization

CHAPTER 1

INTRODUCTION

1.1 Background

For some time now, Malaysia has been preparing for the day when the barriers to entry will come down with the enforcement of World Trade Organisation (WTO) and Asean Free Trade Area (Afta) liberalization rules. To further prepare itself for this challenge, the Malaysian government has taken steps to strengthen the local financial institutions through merger and consolidation of the financial industry. In normal circumstances, merger is a market driven process, which involve willing seller and willing buyer. However, the Malaysian bank merger was initiated by the two most powerful regulatory authorities in their respective jurisdictions, which are Bank Negara Malaysia (BNM) and Securities Commission (SC).

This industry-wide merger exercise which took place in year 1999-2000 has created an intensive wave of mergers that shook out the local banking sector and forever changed the country's landscape. As a result, by 31st December 2000, 50 of the country's 54 financial institutions had been trimmed to just 10 banking groups in the space of a few short months. BNM reported that 94% of the total assets of the domestic banking sector have rationalised and consolidated.

In general, mergers among the financial institutions have been a global trend in recent years due to the effects of the on-going process of globalisation and liberalisation. Recently, Japanese banks have merged and created among themselves four mega-banks,

which are Mizuho Financial Group, Sumitomo Mitsui Banking Corporation, The Mitsubishi Tokyo Financial Group and the UFJ Group. The creation of Mizuho Financial Group, through the merger between Dai Ichi Kangyo Bank, Industrial Bank of Japan and Fuji Bank, has put the Group as the world largest bank in term of assets. (Business Times, 3rd April 2001) In another development, the region biggest bank, Development Bank of Singapore (DBS) has acquired Dao Heng Bank in Hong Kong for around USD5.7 billion to make its presence felt in Hong Kong. All these recent mergers are part of the individual bank's preparation for the globalization and liberalization.

In fact, this research is motivated by the significant increase in merger activities internationally as well as locally. The objective of this paper is to evaluate the effects of the bank mergers' announcements towards the shareholder gains of the banks involved in the merger. Particularly, we would like to find out whether these announcements would create value or abnormal returns on banks that involved in the merger announcements on 29th July 1999 and 14th February 2000, including separating the effects on anchor banks and the target banks.

1.2 Development in the Banking Industry Prior to the Merger

1.2.1 Significant Events Prior to the Merger

Years prior to the industrial wide merger, the banking industry had gone through some degree of rationalization beginning with the banking sector reforms initiated after the 1985-86 recession that necessitated the injection of capital into three ailing commercial banks by BNM. One of the banks, United Asia Bank Bhd, was subsequently merged with

Bank of Commerce (M) Bhd that allowed BNM to divest its entire shareholding in the bank. The more competitive environment and the need to increase capital base have prompted two subsequent mergers in the industry. The first was between DCB Bank Bhd and Kwong Yik Bank Bhd in 1997, which gave birth to RHB Bank Bhd and the second merger, was between Chung Khiaw Bank Bhd and United Overseas Bank (M) Bhd also in 1997.

Unfortunately, the pace of mergers in the banking industry remained slow and unsatisfactory throughout the 1990s. However, the financial crisis in 1997-98 gave the much-needed push for the industry to consolidate and in June 1999, RHB Bank Bhd absorbed Sime Bank Bhd while Bank of Commerce (M) Bhd merged with Bank Bumiputra Malaysia Bhd in October 1999.

With the aim of rebuilding and strengthening the balance sheets of the commercial banks, prudential reforms were introduced. The most significant was the implementation of the Bank for International Settlements (BIS) capital adequacy framework in 1989 which replaced the minimum 'free' capital adequacy ratio requirement. The new capital standard requires capital to be provided for both on- and off-balance sheet assets based on their perceived level of counterparty risk. This capital-asset relationship will ensure that these elements move in tandem such that any increase in risky assets would be supported by an increase in the required level of capital. This approach effectively increases the risk sensitivity of the commercial banks in the structuring of their balance sheet. The new capital adequacy framework also saw the concept of bank holding companies being used

to reorganize bank groups in order to improve the Risk Weighted Capital ratio (RWCR) of the commercial banks. Under the RWCR framework, investments in subsidiaries are deducted from the capital base of the parent banks, thereby reducing their RWCR. Thus, a bank holding company allows the bank to divest its subsidiaries to the holding company, freeing its capital for greater loan asset expansion.

A major regulatory and legislative milestone also took place in 1989 with the enactment of the Banking and Financial Institution Act 1989 (BAFIA) which replacing the Banking Act 1973 and Finance Companies Act 1969. The introduction of BAFIA was intended to provide an integrated supervision of the Malaysian financial institutions and to modernise and streamline the laws relating to banking and all other financial institutions came under one supervisory body. Over time, growing competition in the banking system had resulted in the blurring of demarcation of business lines between the three traditional groups of banking institutions under BNM's supervision, namely commercial banks, merchant banks and finance companies. This had led to a convergence on the methodology of supervision of these institutions through the enactment of BAFIA, including discount houses and money brokers, which were previously supervised on an administrative basis, under one common legal supervisory framework.

BNM also introduced the two-tier regulatory system (TTRS) for the commercial banks in 1994, with the objective of accelerating the pace of liberalization for strong and healthy institutions. The TTRS provided the impetus for the emergence of a core of well-managed and highly capitalized commercial banks, which would be able to grasp

opportunities for innovation and face greater competition in light of financial globalization and liberalization. The system permitted well-managed banking institutions with strong financial standing to carry out specific new activities and conduct certain aspects of their operations under a more liberal regulatory environment. To qualify for Tier-1 status, commercial bank were required to meet minimum shareholders' funds of RM500 million by end 1995, which would then be increased to RM1 billion by end 2000.

In addition, they were also required to achieve a strong rating under the CAMEL framework which evaluated five critical components of banking operations i.e.: capital adequacy, asset quality, management capacity, earnings performance and liquidity position. A total of 11 commercial banks qualified for the Tier-1 status by end 1996.

The TTRS had a significant impact on the balance sheet of commercial banks as could be seen in the substantial growth of the commercial banks' capital and reserve from RM10 billion at end 1993 to RM25.2 billion at end 1996, due largely to new capital injection. Pressed on the need to generate high rates of return for the new capital, there was also a significant rise on the asset side of commercial banks' balance sheets, particularly on loans extended and holdings of marketable securities which almost doubled from RM117 billion and RM26.8 billion to RM217.8 billion and RM51 billion respectively within 1993 to 1996. The TTRS was eventually abolished in 1999 due to its negative impact of inducing aspiring banking institutions to increase their asset base in a rapid manner to keep up with the required earnings on capital. The financial crisis in 1997-98 showed that

the asset quality of banks was affected as a result of the pressure to record rapid loan growth.

1.2.2 Progress in the Banking Industry Prior to the Merger

The commercial banks are the main players in the banking system. They are the largest and most significant providers of funds in the banking system with total loans and total deposits amounting to RM285.1 billion and RM287.6 billion respectively as at end June 1999, representing approximately 76% and 71% of the banking system's total loans and deposits respectively.

As at end June 1999, there are 34 commercial banks (excluding Bank Islam Malaysia Bhd) operating with a total of 1,735 branches nation wide, of which 13 are locally incorporated foreign banks. There are approximately 63,889 staff employed by the commercial banks in the country, an increase of about 53.6% since 1988.

Table 1.1: Commercial Banks in Malaysia – Malaysian Banks (RM million)

Name of Bank	Year of commencement of business in Malaysia	Total assets as at end financial year 1998/1999 (RM million)
1. Arab-Malaysian Bank Berhad ¹	1957	12,614.60
2. Ban Hin Lee Bank Berhad	1935	6,820.80
3. Bank Bumiputra Malaysia Berhad ²	1966	38,164.70
4. Bank of Commerce (M) Berhad	1973	20,382.70
5. Bank Utama (M) Berhad	1976	7,140.90
6. BSN Commercial (M) Berhad ⁴	1975	6,565.70
7. EON Bank Berhad ⁵	1964	9,149.00
8. Hock Hua Bank	1951	4,934.60
9. Hong Leong Bank Berhad ⁶	1923	15,094.50
10. International Bank Malaysia Berhad ⁷	1961	969.00
11. Malayan Bank Berhad	1960	77,896.00
12. Multi-Purpose Bank Berhad ⁸	1957	7,658.50
13. Oriental Bank Berhad	1937	8,866.70
14. Perwira Affin Bank Berhad	1976	15,343.10
15. PhileoAllied Bank Bank (M) Berhad ⁹	1966	10,605.80
16. Public Bank Berhad	1966	31,581.90
17. RHB Bank Berhd ¹⁰	1965	51,285.20
18. Sabah Bank Berhad	1979	2,670.10
19. Southern Bank Berhad	1965	8,193.10
20. The Pacific Bank Berhad	1922	10,955.70
21. Wah Tat Bank Berhad	1955	724.70
22. Bank Islam Malaysia Berhad	1983	5,698.40

Source: Bank Negara Malaysia

¹ Formerly known as Security Pacific Asian Bank Limited prior to 1994.

² The conventional (non-Islamic) assets and liabilities of the bank had been transferred to the newly merged Bumiputra-Commerce Bank, which began operation in 1 October 1999. Bank Bumiputra Malaysia Berhad remains involved exclusively in the Islamic banking sector under the name of Bank Muamalat Malaysia Berhad.

³ Bank of Commerce Berhad (BCB) and United Asian Bank Berhad (UAB) were merged in 1991. UAB's name was changed to Bank of Commerce (M) Berhad while the banking license of BCB was surrendered. On 1 October 1999, the bank was renamed Bumiputra-Commerce Bank Berhad following the absorption of the conventional (non-Islamic) assets and liabilities of Bank Bumiputra Malaysia Berhad.

⁴ Formerly known as Bank Buruh (M) Berhad prior to 1995.

⁵ Formerly known as Kong Ming Bank Berhad prior to 1992.

⁶ Formerly known as MUI Bank Berhad prior to 1994.

⁷ Formerly known as Hock Hua Bank (Sabah) Berhad prior to 1997.

⁸ Formerly known as Malaysian French Bank Berhad prior to 1996.

⁹ Formerly known as United Overseas Bank Limited prior to 1994 and AlliedBank (M) Berhad prior to 1997.

¹⁰ Kwong Yik Bank Berhad and DCB Bank Berhad (DCB) were merged in 1997, after which DCB was renamed as RHB Bank Berhad.

Table 1.2: Commercial Banks in Malaysia – Foreign Banks (RM million)

Name of Bank	Year of commencement of business in Malaysia	Total assets as at end financial year 1998/1999 (RM million)
1 ABN AMRO Bank Berhad	1888	1,830.50
2 Bangkok Bank Berhad	1959	699.90
3 Bank of America Malaysia Berhad	1959	1,597.00
4 Bank ofTokyo-Mitsubitshi (M) Berhad	1959	2,711.70
5 Citibank Berhad	1959	13,719.50
6 Deutsche Bank (M) Berhad	1968	1,879.80
7 HSBC Bank (M) Berhad	1884	25,187.30
8 OCBC Bank (M) Berhad	1932	15,882.40
9 Overseas Union Bank (M) Berhad	1958	6,460.40
10 Standard Chartered Bank Malaysia Berhad	1875	17,009.10
11 The Bank of Nova Scotia Berhad	1973	1,261.10
12 The Chase Manhattan Bank (M) Berhad	1973	1,261.10
13 United Overseas Bank (M) Berhad ¹¹	1956	10,911.60

Source: Bank Negara Malaysia

¹¹ Formerly known as Lee Wah Bank Limited prior to 1994. Chung Khiaw Bank (M) Berhad merged with United Overseas Bank (M) Berhad in 1997.